Supreme Court, U.S.
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No. 85-288

IN THE

Supreme Court of the United States

OCTOBER TERM 1985

JACK DEANE and JOSEPH DEANE,

Petitioners,

—v.—

THOMSON MCKINNON SECURITIES, INC., PEAT, MARWICK, MITCHELL & CO. and MEDICAL AND BUSINESS FACILITIES (A Louisiana Partnership),

Respondents.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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QUESTIONS PRESENTED

1. Whether the courts below erred in holding that the petitioners had failed to state a claim upon which relief could be granted under the federal securities laws when, after three attempts to do so, petitioners failed to identify the statements they claimed were false or misleading or the conduct of each defendant that allegedly provided a predicate for their claims.

2. Whether the Court of Appeals erred in declining to decide whether a private right of action is available under Section 17(a) of the Securities Act of 1933 when, even assuming the existence of such a right of action, petitioners had failed to allege the essential elements of such a claim.

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Respondents.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

STATEMENT OF THE CASE

Petitioners purchased revenue bonds issued in 1981 to finance the acquisition, renovation and reopening of New Orleans General Hospital which had ceased operation in 1979 and was just emerging from bankruptcy as a newly formed corporation.

The bonds were offered by means of an Official Statement which, petitioners alleged, incorporated certain hospital-prepared financial projections for the annual periods ending

September 30, 1981 through September 30, 1985 and a "financial feasibility study" (*not* an audit) of the hospital's future plans for facilities modification allegedly prepared by respondent Peat, Marwick, Mitchell & Co. ("Peat Marwick"). Petitioners did not allege that they ever read or relied upon the Official Statement or the feasibility study, nor did they allege that Peat Marwick conducted any audit of the hospital or rendered any opinion on any of its financial statements.

Almost a year after the offering, the hospital's independent auditors, Aucoin, Sanchez & Hall, completed an audit of the hospital's financial statements for its first 11 months of operation—i.e., the period ending December 31, 1981 — and issued a report thereon which, *inter alia*, disclaimed any opinion on those financial statements and noted certain deficiencies in the hospital's record-keeping and system of internal control existing at the time of the audit.

Petitioners commenced this action in 1983 against the hospital, the underwriter of the bonds and Peat Marwick. Their initial complaint, which did not even identify what provisions, if any, of the federal securities laws they purported to sue under, was dismissed without prejudice by the District Court for failure to comply with the basic pleading requirements of the Federal Rules of Civil Procedure. Fed. R. Civ. P. 8(a)(2), 8(e)(1), 9(b). Petitioners' amended complaint, which merely added references to Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1982) (the "1934 Act"), and Section 17(a) of the Securities Act of 1933, 15 U.S.C. § 77q(a) (1982) (the "1933 Act"), was similarly dismissed by the District Court with leave to amend.

When, however, petitioners' second amended complaint proved to be no better than its predecessors, the District Court dismissed it with prejudice, stating that petitioners had failed to identify what statements they claimed were false or misleading and what action or inaction by each defendant allegedly provided a predicate for their claims and had failed to allege that they read or relied upon the feasibility study. The District Court's opinion is reported at 586 F. Supp. 44 (D.D.C. 1984).

The District Court's dismissal was affirmed by the Court of Appeals in a *per curiam* judgment.

REASONS FOR DENYING THE WRIT

I. DISMISSAL OF THE COMPLAINT WAS BASED ON ESTABLISHED PRECEDENT

Petitioners' second amended complaint was dismissed on the ground that it failed to allege the basic elements of a claim and sought to predicate charges of fraud solely on the hindsight observation that financial forecasts for a newly formed entity were not flawless. No wrongful acts by Peat Marwick were alleged, nor were any facts alleged from which an inference of fraudulent intent—*scienter*—on the part of Peat Marwick may fairly have been drawn.

Under the established precedents on which the courts below relied, petitioners' complaint was properly dismissed. *Decker v. Massey-Ferguson, Ltd.*, 681 F.2d 111, 114 (2d Cir. 1982) ("a complaint 'must allege with some specificity the acts constituting the fraud' . . ."); *Segal v. Gordon*, 467 F.2d 602, 607 (2d Cir. 1972) (" 'there must be allegations of facts amounting to deception in one form or another . . .' ").

As this Court held in *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 199 (1976), *scienter* is an essential element of a violation of Section 10(b) of the 1934 Act. At minimum, a complaint must allege facts that give rise to an inference of fraudulent knowledge or intent. *Ross v. A.H. Robins Co.*, 607 F.2d 545, 558 (2d Cir. 1979), *cert. denied*, 446 U.S. 946 (1980); *Denny v. Barber*, 576 F.2d 465, 470 (2d Cir. 1978).

Petitioners failed after three attempts to satisfy these fundamental pleading requirements. Dismissal was plainly appropriate under the circumstances.[1]

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1 *Herman & MacLean v. Huddleston*, 459 U.S. 375 (1983), on which petitioners rely, addressed the issue of burden of proof in actions under Section 10(b) and has no bearing on the requirement that petitioners plead the basic elements of their claim for relief.

II. THE COURT OF APPEALS WAS CORRECT IN DECLINING TO DECIDE WHETHER A RIGHT OF ACTION SHOULD BE IMPLIED UNDER SECTION 17(a) OF THE 1933 ACT

This Court has four times raised and left open the question whether Section 17(a) of the 1933 Act gives rise to an implied private damage remedy. *See Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 733-34 n.6 (1975); *International Brotherhood of Teamsters v. Daniel*, 439 U.S. 551, 557 n.9 (1979); *Aaron v. SEC*, 446 U.S. 680, 689 (1980); *Herman & MacLean v. Huddleston*, 459 U.S. 375, 378 n.2 (1983). The issue also remains unresolved in the District of Columbia Circuit, *Wachovia Bank & Trust Co. v. National Student Marketing Corp.*, 650 F.2d 342, 350 n.19 (D.C. Cir. 1980), *cert. denied*, 452 U.S. 954 (1981), in the First Circuit, *Cleary v. Perfectune, Inc.*, 700 F.2d 774, 780 (1st Cir. 1983), in the Second Circuit, *Yoder v. Orthomolecular Nutrition Institute, Inc.*, 751 F.2d 555, 559 n.3 (2d Cir. 1985); *Zerman v. Ball*, 735 F.2d 15, 23 (2d Cir. 1984); *Chemical Bank v. Arthur Andersen & Co.*, 726 F.2d 930, 945 (2d Cir. 1984), and in the Seventh Circuit, *Peoria Union Stock Yards Co. v. Penn Mutual Life Insurance Co.*, 698 F.2d 320, 323 (7th Cir. 1983).[2]

2 Subsequent to this Court's decision in *Aaron v. SEC*, 446 U.S. 680 (1980), lower courts reaching the issue have been virtually unanimous in the view that no implied private right of action for damages exists under Section 17(a). *See, e.g., Keys v. Wolfe*, 709 F.2d 413, 416 (5th Cir. 1983), *aff'g in pertinent part*, 540 F. Supp. 1054, 1060 (N.D. Tex. 1982); *Landry v. All American Assurance Co.*, 688 F.2d 381, 384-91 (5th Cir. 1982); *Wayne Investment, Inc. v. Gulf Oil Corp., [1983-1984] CCH Fed. Sec. L. Rep.* ¶ 99,612 at 97,409 (D. Mass. 1983), *aff'd*, 739 F.2d 11 (1st Cir. 1984); *Ackerman v. Clinical Data, Inc.*, [Current] CCH Fed. Sec. L. Rep. ¶ 92,207 at 91,569-71 (S.D.N.Y. 1985); *Weiss v. Gibson*, [1984-1985] CCH Fed. Sec. L. Rep. 92,090 at 91,467 (D.D.C. 1985); *Sheftelman v. N.L. Industries, Inc.*, [1984-1985] CCH Fed. Sec. L. Rep. ¶ 92,040 at 91,190-91 (D.N.J. 1985); *North American Financial Group, Ltd. v. S.M.R. Enterprises, Inc.*, 583 F. Supp. 691, 695-97 (N.D. Ill. 1984); *Summer v. Land & Leisure, Inc.*, 571 F. Supp. 380, 386-87 (S.D. Fla. 1983); *Kimmel v. Peterson*, 565 F. Supp. 476, 482-88 (E.D. Pa. 1983); *Sweeney v. Keystone Provident Life Insurance Co.*, 578 F. Supp. 31, 33 (D. Mass. 1983); *Massaro v. Vernitron Corp.*, 559 F. Supp. 1068, 1078 (D. Mass. 1983); *Basile v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 551 F. Supp. 580 (S.D. Ohio 1982); *Hill v. Der*, 521 F. Supp. 1370, 1378 (D. Del. 1981) (collecting and analyzing cases), *adhered to Hill v. Equitable Trust Co.*, 562 F. Supp. 1324 (D. Del. 1983).

Consistent with these precedents, the Court of Appeals declined to reach the issue of whether a private right of action for damages should be allowed under Section 17(a) of the 1933 Act in view of petitioners' failure to allege the basic elements of such a claim, even assuming that it were to exist.

In the absence of an adequate pleading and of a decision on the issue by the Court of Appeals, there is no reason for this Court to address the Section 17(a) question at this time.

CONCLUSION

Petitioners fail to state any sound reason for this Court to grant certiorari. No important question of federal law has been presented nor did the Court of Appeals render a decision on a federal question in conflict with the decisions of this Court or another federal court of appeals. Accordingly, Peat Marwick respectfully submits that the petition for writ of certiorari should be denied.

Respectfully submitted,

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